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Guidance Provided on "Normal Growth" for Income Trusts and Other Flow-Through Entities

Following the close of financial markets today, the Department of Finance provided further guidance on "normal growth" in respect of the tax measures announced on October 31, 2006 regarding income trusts and other flow-through entities.

On October 31, 2006, the Minister of Finance, the Honourable Jim Flaherty, announced a Tax Fairness Plan. The Plan includes a Distribution Tax on certain amounts distributed by a "specified investment flow-through" (SIFT) trust or SIFT partnership. This new tax applies as of 2007 to new entities, but is deferred until 2011 for SIFTs that were publicly traded as of October 31, 2006.

The deferred application of these measures is, however, conditional on existing SIFTs respecting the policy objectives of the proposals. Materials released with the Minister's announcement indicated that, for example, the undue expansion of an existing SIFT might cause the deferral to be rescinded. On the other hand, the continuation of the normal growth of a SIFT would not raise concerns.

This document provides existing SIFTs with more detail as to what is meant by "normal growth" in this context. The Department's guidance has been prepared following consultations with many publicly-traded trusts and partnerships, and is based on its observations as to the range of growth arising in the normal course of business.

Specifically, the Department will not recommend any change to the 2011 date in respect of any SIFT whose equity capital grows as a result of issuances of new equity, in any of the intervening periods described below, by an amount that does not exceed the greater of $50 million and an objective "safe harbour" described below.

The safe harbour amount will be measured by reference to a SIFT's market capitalization as of the end of trading on October 31, 2006. Market capitalization is to be measured in terms of the value of a SIFT's issued and outstanding publicly-traded units. For this purpose, it would not include debt (whether or not that debt carried a conversion right or was itself publicly-traded), options or other interests that were convertible into units of the SIFT.

For the period from November 1, 2006 to the end of 2007, a SIFT's safe harbour will be 40 percent of that October 31, 2006 benchmark. A SIFT's safe harbour for each of the 2008 through 2010 calendar years will be 20 percent of that benchmark, together allowing growth of up to 100 percent over the four-year transition period.

The following are additional details of the Department's approach:

- The annual safe harbour amounts are cumulative: for example, a SIFT that issues no new equity in 2007 will as a result enjoy a greater safe harbour amount in 2008. The $50 million amounts, in contrast, are not cumulative.
- New equity for these purposes includes units and debt that is convertible into units; if attempts are made to develop other such substitutes for equity, those may be included as well.
- Replacing debt that was outstanding as of October 31, 2006 with new equity, whether through a debenture conversion or otherwise, will not be considered growth for these purposes. New, non-convertible debt can also be issued without affecting the safe harbour; however, the replacement of that new debt with equity will be counted as growth.
- An issuance by a SIFT of new equity will not be considered growth to the extent that the issuance is made in satisfaction of the exercise by another person or partnership of a right in place on October 31, 2006 to exchange an interest in a partnership, or a share of a corporation, into that new equity.
- The merger of two or more SIFTs each of which was publicly-traded on October 31, 2006, or a reorganization of such a SIFT, will not be considered growth to the extent that there is no net addition to equity as a result of the merger or reorganization.

Consistent with the objectives of Tax Fairness Plan, the Department of Finance will monitor developments in the market and will take action accordingly to ensure that this guidance is respected.

Conversion of Trusts to Corporations

It is intended that conversions of a SIFT to a corporation be allowed to take place without any tax consequences to investors on the conversion. The Department has received a number of representations concerning the rules applying on the conversion of a SIFT to a corporation, and is examining whether any impediments to conversion exist under the current income tax rules. If so, changes will be recommended to ensure that appropriate rules are in place to facilitate such conversions.

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